DEPARTMENT OF STATE REVENUE

04-20110584.LOF

Letter of Findings Number: 04-20110584
Use Tax
For Tax Years 2008 and 2009

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ISSUES

I. Use Tax–Manufacturing Exemption.

Authority: Indiana Dep't of Revenue v. Interstate Warehousing, Inc. 783 N.E.2d 248 (Ind. 2003); IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-5-3; IC § 6-8.1-5-1; 45 IAC 2.2-3-4.

Taxpayer protests the imposition of use tax on two items which it believes qualify for the manufacturing exemption.

STATEMENT OF FACTS

Taxpayer is an Indiana business. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had not paid sales tax on certain purchases of tangible personal property during the tax years 2008 and 2009. The Department therefore issued proposed assessments for use tax and interest for those years. Taxpayer protests the imposition of use tax on two items included as taxable. Taxpayer waived the administrative hearing, requesting that the Hearing Officer write this Letter of Findings based on the material previously submitted. Further facts will be supplied as required.

I. Use Tax–Manufacturing Exemption.

DISCUSSION

Taxpayer protests the imposition of use tax on two items which it believes qualify for the manufacturing exemption. The Department determined that the two items in question were not manufacturing equipment and that the imposition of use tax was appropriate since sales tax was not paid at the time of purchase. Taxpayer disagrees with the Department's determination. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

The sales tax is imposed by IC § 6-2.5-2-1, which states:

(a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.

(b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

The use tax is imposed under IC § 6-2.5-3-2(a), which states:

(a) An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.

Also, 45 IAC 2.2-3-4 provides:

Tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax for such property, unless the Indiana state gross retail tax has been collected at the point of purchase.

Therefore, when tangible personal property is acquired in a retail transaction and is stored, used, or consumed in Indiana, Indiana use tax is due if sales tax has not been paid at the point of purchase. The Department determined that Taxpayer purchased several items in retail transactions but did not pay sales tax on the purchases. The Department therefore issued proposed assessments for Indiana use tax on the purchase of those items.

Taxpayer protests that the two items in question, a shredder and a conveyor, are used in its alternative fuel manufacturing process. As described in both the audit report and in Taxpayer's protest letter, Taxpayer takes shredded paper goods and blends in other shredded items such as rubber and plastics to form an alternative fuel which it sells to a cement manufacturer. The cement manufacturer burns this blend of shredded items in its production process.

IC § 6-2.5-5-3(b) provides:

Except as provided in subsection (c), transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.

Therefore, tangible personal property must be directly used in the direct production of other tangible personal property in order to qualify for the exemption found in IC § 6-2.5-5-3(b). Taxpayer's protest letter and the audit

report both state that Taxpayer's customer needs the shredded materials to burn at 11,000 BTUs. Taxpayer believes that the shredding and blending of the various materials to meet this level constitute "manufacturing" and that the equipment used to perform this process qualify for the manufacturing exemption.

The Indiana Supreme Court provided guidance in Indiana Dep't of Revenue. v. Interstate Warehousing, Inc. 783 N.E.2d 248, 252 (Ind. 2003):

> A second requirement of the exemption at issue here is that the taxpayer's business be "manufacturing, processing, refining," or one of the other businesses listed in the statute. Interstate contends that it meets this requirement because it is engaged in "processing." Pet'r's Mem. In Supp. Of Mot. For Summ. J. ("Pet'r's Mem."), Appendix at 96. The Indiana Administrative Code defines "processing" for these purposes as follows:
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> Processing or refining is defined as the performance by a business of an integrated series of operations which places tangible personal property in a form, composition, or character different from that in which it was acquired. The change in form, composition, or character must be a substantial change. Operations such as distilling, brewing, pasteurizing, electroplating, galvanizing, anodizing, impregnating, cooking, heat treating, and slaughtering of animals for meal or meal products are illustrative of the types of operations which constitute processing or refining, although any operation which has such a result may be processing or refining. A processed or refined end product, however, must be substantially different from the component materials used.
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> Ind. Admin. Code tit. 45 r. 2.2-5-10(k). Interstate argues that it is engaged in processing because it processes chilled ammonia to produce conditioned air and sells "the cooled, dehydrated and conditioned air that it processes." Pet'r's Mem., App. at 90. But we think the Department has the better part of the argument: "Interstate [does not] 'perform an integrated series of operations' resulting in a transformed end product to Interstate's customer.... The cool air merely maintains the customer's previously manufactured goods. There is no substantial change in 'form, composition, or character' to those goods. The cold air is only incidental to the service of storing previously manufactured goods." Mem. in Supp. of Resp. to Mot. For Summ. J. and Cross-Mot. For Summ. J., App. at 76. We hold that Interstate is not engaged in the "business of... processing."
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> (Emphasis added).

The Department does not agree that Taxpayer's process results in a substantial change to the tangible personal property. The end product is not substantially different from the component materials, as the court in Interstate Warehousing stated is required. As explained above, the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made. In this case, Taxpayer has not established that the shredder and conveyor meet the requirements of the manufacturing exemption, and so Taxpayer has not met the burden of proving the proposed assessments wrong.

FINDING

Taxpayer's protest is denied.

Posted: 06/27/2012 by Legislative Services Agency
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